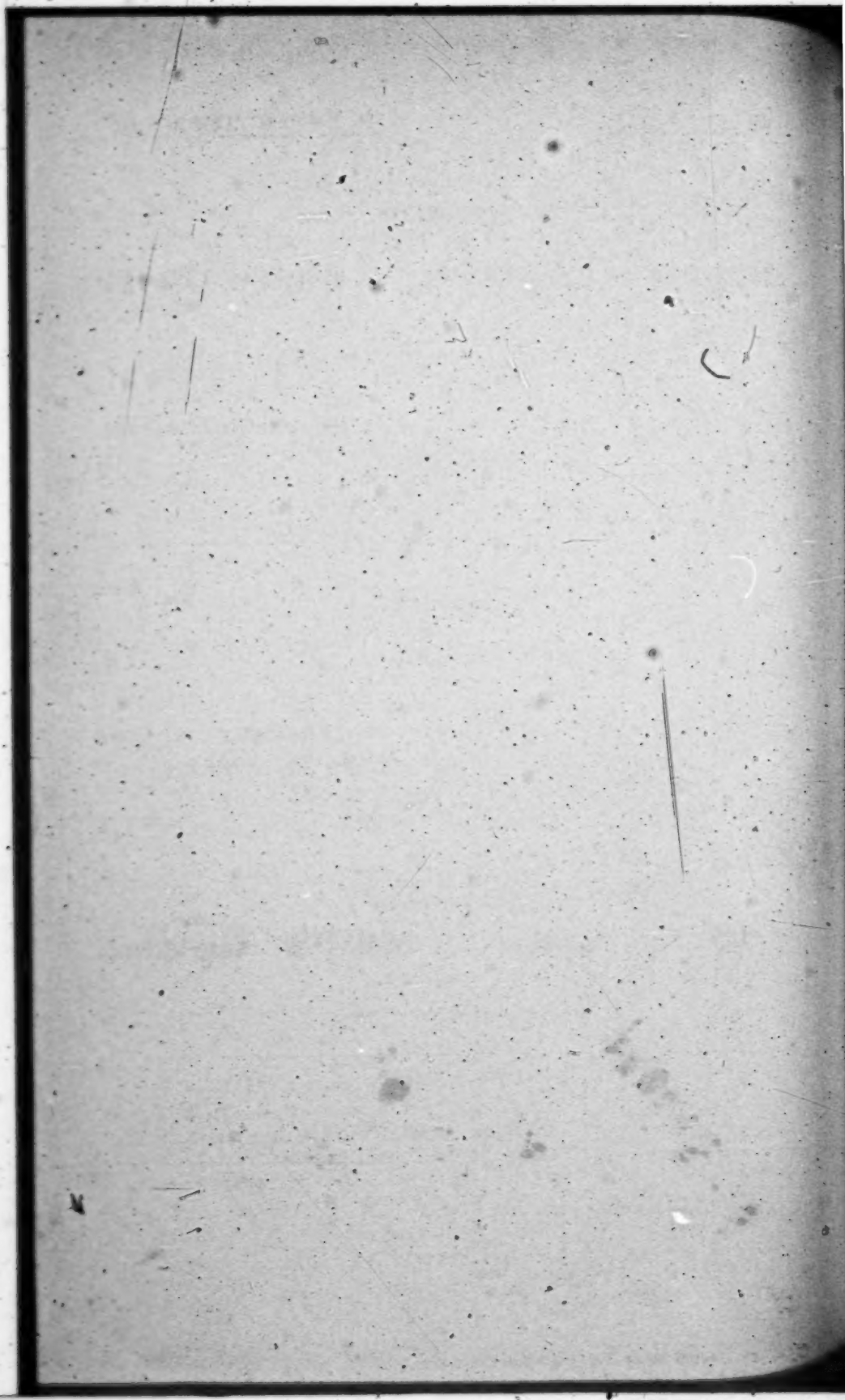

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

No. 199.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

SAMUEL F. HOUSTON.

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT.

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v.

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BRIEF FOR THE RESPONDENT.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals (R. 56) is reported in 39 F. (2d) 351. The findings of fact and the opinion of the Board of Tax Appeals (R. 9-16) are reported in 13 B. T. A. 279.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered March 14, 1930 (R. 63). Petition for certiorari was filed in this Court on June 14, 1930, and was granted October 13, 1930 (R. 64). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

STATEMENT OF QUESTION INVOLVED.

Where a taxpayer in 1906 enters into a transaction for profit wherein, as part of the plan of reorganization of a Trust Company in the hands of a Receiver, he subscribed money to guarantee a specified value to certain specific assets held by it, under a written agreement that he is to be repaid only out of the excess realization over said specified amount from the uncontrolled administration of said assets by the Trust Company, and said administration is concluded after fourteen years and the taxpayer receives a first and final dividend on the amount of money advanced by him, is not the difference between the amount advanced by the taxpayer and the amount received from the final administration a deductible loss to the taxpayer under Section 214 (a) 5 of the Revenue Act of 1918, for the year in which the first and final distribution is paid?

STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved are printed in Appendix to Petitioner's brief pp. 18-20.

STATEMENT OF THE CASE.

The statement of facts in the petitioner's brief, while substantially correct in so far as it goes, omits certain facts

which are essential to give a clear picture of the transaction out of which the respondent's loss arose, and respondent feels obliged therefore to restate the facts in more detail. The omission by the petitioner of all reference to the nature of the transaction which was found by the Board of Tax Appeals and the Circuit Court of Appeals to have been that in the nature of *a guaranty*, essentially changes the aspect of the case.

The facts as found by the Board of Tax Appeals (R. 10-14) and as appear elsewhere in the record where specifically noted, are as follows:—

The respondent was a stockholder and director of the Real Estate Trust Company of Philadelphia.

The Real Estate Trust Company of Philadelphia closed its doors in the year 1906, and on August 28th of that year, George H. Earle, Jr., was appointed receiver for it by the Court of Common Pleas of Philadelphia County, Pennsylvania. The financial embarrassment of the Real Estate Trust Company was brought about by improper conduct of its affairs by its president, Frank Hipple. Hipple loaned excessive amounts to Adolph Segal and took therefor collateral which could not be easily liquidated, but which was not without value.

The receiver for the Real Estate Trust Company proposed a plan of reorganization for that company which included as one of its provisions the creation of a fund of $2,505,000 from subscriptions by directors of the company to guarantee a value of $3,000,000 for the Segal collateral, designated in the plan "Segal Matters." The company was to be given the $2,505,000 outright and then was to have in addition the first $3,000,000 which might be realized from the "Segal Matters." The subscribers were to be reimbursed, if at all, by all of the excess over $3,000,000 which might be realized from the "Segal Matters." This plan of reorganization became effective. It provided in part that the subscribers to the $2,505,000 fund made such subscriptions with the understanding that if from the administration of the "Segal Matters" $3,000,000 should be realized, the

subscribers were to receive any excess over this amount. No restrictions or time limits were placed upon the Real Estate Trust Company in regard to its administration and final disposition of the assets included in the "Segal Matters." The Real Estate Trust Company resumed business on November 1, 1906, and thereafter and until December 30, 1920, the "Segal Matters" were administered exclusively by it under the direction of George H. Earle, Jr., formerly receiver and thereafter president of that company.

The respondent, a director, subscribed $755,000 to the fund and when the plan became effective by the required consents of creditors, stockholders, and others, and the subscribers to this fund were called upon to make payment of their subscription, respondent found that a payment by him of the full amount of his subscription would necessitate a sacrifice of his securities and investments in the then existing market at considerable loss to him, and at his proposal his sisters, and his mother took participating interests in his subscription. Of the $755,000 subscribed by respondent, respondent actually contributed $305,000 of his own money and his sister, Sallie H. Henry, contributed $200,000 to the fund.

The respondent at the time he subscribed to the guaranty fund believed that the "Segal Matters" had considerable potential value which under Earle's administration could be converted into a sufficient amount of cash to repay the subscribers the amount of their subscription with interest and possibly some profit in addition.

At and before the time that the respondent herein subscribed to the guaranty fund, George H. Earle, Jr., the receiver for the Real Estate Trust Company, had had conversations with the directors in which he expressed a belief that a sufficient amount might be realized from the "Segal Matters" to repay to the subscribers the amount of their subscription with interest and possibly a profit.

The facts as further found by the Board show that Segal had secured a loan of $1,250,000 from Gustave E. Kissel. As collateral for this loan, Segal gave certain

bonds and stock which had been deposited with the Real Estate Trust Company as collateral security for loans made by it to Segal and which had been wrongfully withdrawn from the Real Estate Trust Company by Segal with the permission of Hipple. Included in this collateral were certain bonds and shares of stock of the Pennsylvania Sugar Refining Company and in connection with the loan it was agreed between Kissel and Segal that until the loan was repaid, Kissel, or some one to be named by him, should have the right to select four out of seven directors of the Pennsylvania Sugar Refining Company and that the latter's refinery should not be operated.

At the time the subscriptions to the guaranty fund were made, a suit against the American Sugar Refining Company under the Sherman Anti-Trust Act was contemplated on behalf of the Pennsylvania Sugar Refining Company and the value of the "Segal Matters" depended to some extent upon the successful prosecution of such a suit.

Such a suit was brought in the United States District Court for the Southern District of New York for $10,000,000 and another in the Court of Chancery in the New Jersey, on the ground that Kissel, as agent for American Sugar Refining Company, had made a contract in restraint of trade with Segal. In January, 1910, the pending litigation was compromised upon the delivery to the Real Estate Trust Company by the American Sugar Refining Company of certain bonds wrongfully withdrawn from the Real Estate Trust Company among which were bonds of the Pennsylvania Sugar Refining Company. The Real Estate Trust Company afterwards converted the latter bonds, through a foreclosure, into 7268 shares of stock in the reorganized company, thereafter called Pennsylvania Sugar Company. This was on or before January 22, 1912.

Some question arose between the parties in regard to the interpretation of the subscription agreement and on May 5, 1916, a supplemental agreement was entered into. At this time and for some time prior thereto the principal unliqui-

dated assets of the original "Segal Matters" were the 7268 shares of stock in the Pennsylvania Sugar Company and under the supplemental agreement it was provided that when this stock was disposed of the contributors to the guaranty fund should receive one-fourth of the proceeds, but in no event more than their original subscriptions.

In the latter part of 1920, the parties concerned, after full investigation, concluded that the liquidation agreement had rendered its maximum of service and that the remaining Segal assets would not have any greater value during a substantial period of time in the future than they then had. Whereupon, the subscribers either individually or by their duly constituted representatives entered into separate agreements which as a group provided for complete liquidation of the "Segal Matters" by the Real Estate Trust Company distributing one-fourth of the 7268 shares of Pennsylvania Sugar Company stock to the subscribers to the fund in proportion to the amount of their subscription in full satisfaction of all agreements of the parties pertaining thereto. The subscribers never received any other return on their subscriptions.

Samuel F. Houston entered into such an agreement on December 30, 1920, and on that date, in accordance with the terms of the agreement, received 548.734 shares of Pennsylvania Sugar Company stock. He, personally, was entitled to 222 of these shares. The remaining shares he received for his sisters and others who had subscribed through him. These latter shares were later distributed to them by him, 158.61 shares being delivered to Sallie H. Henry in the early part of 1921.

Each share of Pennsylvania Sugar Company stock received by the respondent at the time received had a fair market value of $150.

At the end of 1920, Samuel F. Houston wrote off his books as a loss of $271,700 computed by deducting the value of the stock which he received from $305,000, the amount of his subscription. In reporting income for 1920 he deducted this amount as a loss.

As further appears (R. 44-45) this loss was allowed by the Field Agent but disallowed by the Commissioner in a letter of June 2, 1924, for the reason therein given:—

> "In regard to the disallowance of $271,700.00 you are advised that under the provisions of Revenue Act of 1918, no loss can be determined with respect to the transaction in question until the stock which you received as reimbursement is disposed of, and the evidence is to the effect that the stock was still in your possession at the close of the year 1920."

This rejection was affirmed by the Commissioner December 18, 1925 (R. 6), and on an appeal to the Board of Tax Appeals by respondent, the action of the Commissioner was sustained for the reason that respondent failed to show what the March 1, 1913, value was of his interest in the guaranty agreement.

SUMMARY OF ARGUMENT.

The respondent proved a loss deductible in 1920 under Section 214 (a) 5 of the Revenue Act of 1918, upon a guaranty transaction entered into in 1906. This loss is a permissible deduction *in toto*, no valuation as of March 1, 1913, of respondent's right or position with respect to the Trust Company's administration being relevant. If March 1, 1913, value of respondent's position as guarantor is relevant, respondent, under the record facts, has sustained such burden of proof as may rest upon him by showing that his entire loss occurred after March 1, 1913. The Commissioner offered no proof to the contrary.

ARGUMENT.

It is submitted that from the peculiar facts of this case, the only proper basis for measuring petitioner's admitted loss is by taking the basis adopted by petitioner in making

his return, namely—the difference between his subscription to the Guaranty Fund in 1906 and the value of the pro rata share of the proceeds of said fund received by him in 1920. The nature of the entire transaction admits of no other basis.

The Real Estate Trust Company of Philadelphia was reorganized and reopened for business November 1, 1906. George H. Earle was discharged as receiver and elected President of the Trust Company. The "Segal Matters" were administered by George H. Earle in his capacity as President of the Trust Company in which was vested, by the terms of the Guaranty Fund agreement, the exclusive and uncontrolled power of administration and liquidation of the "Segal Matters."

In the course of the administration, which extended far beyond the time originally contemplated, differences of opinion developed upon the position and powers of The Real Estate Trust Company, upon the one side, and the contributors or their estates, upon the other.

It was decided by the parties in interest in 1915, while the "Segal Matters" were still being administered by The Real Estate Trust Company for its own account and as trustee for the subscribers, that an interpretation of the original agreements should be obtained from John G. Johnson, Esq., of Philadelphia, who was counsel for George H. Earle, Receiver, and joint author with him of the plan of reorganization of The Real Estate Trust Company. The opinion of Mr. Johnson was asked for and was rendered under date of July 15, 1915 (R. 33).

Mr. Johnson held that the "Segal Matters" were subject to sole administration by The Real Estate Trust Company within its uncontrolled discretion, and that the subscribers to the Guaranty Fund were entitled only to the exercise of an honest administration of ordinary prudence and intelligence and without power to interfere with or direct the manner or time of liquidation.

He further held that when the amount of realization reached Three million dollars, from whatever source ac-

quired, the right of the Trust Company to any additional payment ceased and the right of the subscribers attached, and thereafter all proceeds from the disposition of Segal assets became the property of the subscribers to the fund.

It is to be remembered that Mr. Johnson's opinion was given while the administration of the "Segal Matters" was continuing and speaks of the future when interpreting the rights of the parties to interest, as well as to a pro rata share in the proceeds realized from liquidation of principal assets.

The conclusion which he reached formed the basis for the subsequent agreement entered into between the parties. Mr. Johnson said (R. 33, 36):—

> "Interest is to be allowed in case of an excess sufficient in amount; but it is to be allowed only to the contributors upon the amount of their contributions.
>
> "In my judgment, therefore, the contributors are entitled to any excess in the realization of the 'Segal Matters' which will arise after there has been received from the 'Segal Items' by way of proceeds of sale, and income anterior to their conversion, the sum of $3,000,000."

Mr. Johnson also stated that in his opinion the power to administer by the Trust Company exclusively was not limited by any duty to consult with the subscribers or their representatives (R. 36).

The administration of the "Segal Matters," which in 1916 included stock of the Pennsylvania Sugar Company, continued under the sole direction of The Real Estate Trust Company of Philadelphia until the latter part of the year 1920. It was then agreed between The Real Estate Trust Company and the subscribers to the Guaranty Fund that the agreement with the Trust Company for the administration and liquidation of the "Segal Matters" had served its maximum of usefulness and that thereafter no additional advantages could come from it to any of the parties to it, and that pursuant to the supplemental agreement of May 5, 1916,

it was desirable to terminate the relationship theretofore existing and to liquidate the "Segal Matters" by a distribution in kind to the subscribers of the pro rata share to which each was entitled of the stock of the Pennsylvania Sugar Company.

The agreement of December 30, 1920 (R. 40), was thereupon entered into between The Real Estate Trust Company and each of the subscribers, approved by the members of the Committee, by which distribution in kind was made.

It must be conceded that the basis for the transaction, and the reason why it was entered into, was the expectation of the subscribers that the administration and liquidation of these "securities of uncertain value" would produce a profit to them. This, in effect, was what the Contract of Guaranty was. The subscribers backed their confidence in the hopes of success by their subscriptions, expecting in time that the "Guaranty Fund" would repay with profit. This justifiable expectation continued up to and beyond March 1, 1913. There are no facts upon the record or available for the record to show that as of March 1, 1913, there was not ample foundation for the realization of this expectation.

The respondent contends that for the purpose of determining the tax liability the status of the respondent is no different than it would have been had the subscribers to the Guaranty Fund signed an agreement of guaranty, instead of creating the fund, by which agreement each would have obligated himself to pay his pro rata share of the difference, if any, between $3,000,000 and the amount realized from the "Segal Matters," in consideration of an agreement on the part of the Trust Company that in the event that the "Segal Matters" realized more than $3,000,000 the entire excess should be distributed pro rata among the guarantors.

If such had been the agreement then, in 1920, the respondent would have been called upon to make good his contract of guaranty by the payment of the sum of $271,700. This payment in discharge of that liability would have created a loss in the year when paid. The transaction would

not have produced the anticipated profit, but the loss would have been deductible from the gross income of the respondent in the year when the payment was made.

The total realizable value of the "Segal Matters" which was underwritten by the guarantors in 1906 fell short of the speculative possibilities anticipated for them. The transaction when closed in 1920 was not a profit but a loss. The loss fell upon the guarantors and the extent of it was reflected in the amount of the balance returned to them from the assets which replaced their cash deposited with the "Guaranty Fund" to protect their guaranty.

The ordinary policy of indemnity; the policies covering marine risk, including profit on the cargo for the voyage; marketability of real estate titles and of mortgage bonds; and many other well known, every-day, undertakings are similar in principle to the transaction under consideration. In all such, the loss incurred by the guarantor or indemnitor when it becomes actual has never been disputed as a deductible loss from gross income.

Neither the respondent, nor the Court below question the fact that the cases such as United States *v.* Flannery, 268 U. S. 98; Heiner *v.* Tindle, 276 U. S. 582, and others mentioned in the brief for petitioner, measure the loss on the ordinary transaction entered into before March 1, 1913, relating to property owned outright by the taxpayer by adopting either the value as of that date or the cost, whichever is lower, as the base. But all the authorities which have come to counsel's attention in this transaction have dealt with the property inherently capable of ascertainable value, such as real estate, an insurance policy, instruments evidencing debt and the like. In none of them has the Court applied a March 1, 1913 value to a loss or right of the character herein involved, where the loss of a guarantor, or the value of his correlative right to reimbursement, is not properly ascertainable until the guaranty transaction is liquidated.

It is submitted that the respondent in this case is not asking on this point more than an application of a principle which

if true in denying the right to anticipate a loss, is true also in determining when a loss first occurs, and that neither the date of the transaction which ultimately resulted in the loss, nor any date intermediate between that date and the date of the closing of the transaction, is material. In other words, if the loss on this transaction is of such nature that it can only be determined on one date, namely, December 30, 1920, how can March 1, 1913, have any bearing on such a transaction? This is not a case where a loss can be measured as of March 1, 1913, and December 30, 1920, such as might be the case with the purchase and sale of property. In the latter case there could be a measurable loss or gain in 1913 and in 1920 or at any intermediate date. In this case, the loss can only be determined with reference to one date, *i. e.*, the date when the transaction was liquidated. The provision in the Statute with reference to 1913 values, we submit, is only applicable to property, the loss or gain on which can be ascertained as of that date.

This reasoning seems to find support in the case of Lewellyn, Collector of Internal Revenue *v.* Electric Reduction Company, 275 U. S. 243, in the opinion in which Mr. Justice Stone says:—

> "The statute was intended to apply not only to losses resulting from the physical destruction of articles of value but to those occurring in the operations of trade and business, where the business man has ventured on a course of action in the reasonable expectation that the promised conduct of another will come to pass. Not only the future success of the business but its present solvency depends on the probable accuracy of his prophecy. Only when events prove the prophecy to have been false can it be said that he has suffered. His case is not like that of a man who fails to learn of the theft of his bonds or the burning of his house until a year after the occurrence; but rather resembles the position of a merchant who buys in one year, for sale in the

next, merchandise which shifting fashion renders unsaleable in the latter. It may well be that he whose house has been burned has sustained a loss wehther he knows it or not and may recover a tax paid in ignorance of that material fact. But we cannot say that the merchant whose action has been based not merely on ignorance of a fact but on faith in a prophecy—even though the prophecy is made without full knowledge of the facts—can claim to have sustained a loss before the future fails to justify his hopes.

"Here the only fact relied upon to show a loss is the outcome of the litigations two years after respondent's payment to Jouravleff. There is nothing in the findings from which we could conclude that the respondent in 1918 had ceased to regard his rights under the contract as having value or that there was then reasonable ground to suppose that efforts to enforce them would be fruitless."

It follows from this language that had the respondent claimed a loss in 1913, the petitioner would have disallowed it because of no evidence to support it and the affirmative proof that respondent had not ceased to regard his rights under the Guaranty Agreement as having full valie (R. 49) and this Court apparently would have sustained that finding on the authority just cited. If no deductible loss was available to the petitioner in 1913, it is because the facts failed to show a difference in his position from what it was in 1906—and it cannot be said, therefore, that the actual loss determined in 1920 and not previously ascertainable, must be diminished by assuming that had the transaction closed on March 1, 1913, the loss would have been the same, or greater or less. The statute does not so provide and the reasoning of this Court seems to sustain the Court below in its decision to the contrary.

It is respectfully submitted that these cases, growing out of the Real Estate Trust Company failure, are so dis-

similar from other cases arising under the revenue acts as to create a class for themselves, and to be unavailable as authority for future litigation.

The argument for the petitioner is based on that misconception of the transaction from which the respondent's loss resulted which caused counsel for the petitioner to ignore certain of the facts of record which are essential to a clear understanding of the differences presented by these cases from the authorities relied upon by the petitioner and other decisions of this and the lower Federal courts.

The petitioner apparently understands the transaction under consideration to have been a purchase in 1906 of tangible property by the respondent and a disposition of such tangible property interest in 1920 at less than cost, and because of such understanding has presented the question involved to this Court as one of the ordinary and usual claims for loss arising out of the "sale or other disposition of property, real, personal, or mixed." (Section 202 (*a*) (1) of the Revenue Act of 1918, Appendix to Petitioner's Brief, p. 18.)

The transaction was not that which the petitioner's description presents, and the findings of fact of the Board of Tax Appeals, affirmed by the learned Court below and the basis for its opinion, clearly disclose the relationship of the respondent to the transaction in 1906 to be different from that of the purchaser of tangible property interests.

The transaction, as found by the Board of Tax Appeals, was one entered into by the respondent as a part of the plan of the reorganization of the Real Estate Trust Company of Philadelphia by which the respondent became a subscriber to "the so-called guaranty fund, and in accordance with the agreement of reorganization paid to the Real Estate Trust Company the amount of the respondent's subscription in the year 1906" (R. 15):—

> "This money was thenceforth the property of the Real Estate Trust Company and the subscribers to the fund were to look solely to the excess proceeds which

the Real Estate Trust Company might subsequently realize on certain assets which were called 'Segal matters.' If and when the amount realized by the Real Estate Trust Company from the administration of these 'Segal matters' amounted to $3,000,000, any additional amount which might thereafter be realized from the further administration or disposition of these assets was to belong to the subscribers to the fund."

The Real Estate Trust Company had the power of administration in its sole discretion and was required only to use due diligence and reasonable judgment in the administration, disposition and final liquidation of the "Segal matters." The administration of these assets began in 1906 and were not completed until 1920. The subscribers to the guaranty fund acquired no securities or "rights" of a tangible nature, and at no time had an ownership of or an interest in the "Segal matters," but acquired by the transaction of 1906 as a result of the subscriptions then made to the guaranty fund a position in relation to the Real Estate Trust Company which entitled the respondent and the other subscribers to an accounting when the administration was terminated and a pro rata participation in the proceeds realized in excess of the sum agreed upon as the amount required to replace the capital and surplus of the Trust Company. This right to an accounting and the proceeds thereof the learned Court below described as follows (R. 62):—

"To work out this aspect of the question it will be necessary to determine generally the interest of the contributors, and particularly the petitioner's interest in the Segal matters. It is, because of their nature, difficult to give them a legal definition. Speaking of them in the singular number, it is certain that the petitioning contributor had no legal interest in the Segal securities or matters, or any legal claim to them. Legal title and the right fully to dispose of them was exclusively

in the trust company. The petitioner had, however, a right to a share of the residue of the proceeds of their liquidation, whether in cash or its equivalent. That right was in the nature of a chose in action, yet a very restricted chose in action which he could not enforce until liquidation of the Segal matters had been fully completed, whenever that should be."

The purpose of the guaranty fund was to insure to the Trust Company, in 1906, liquid assets for use in its business as a going concern pending the realization upon the "Segal matters" then estimated to be of great value although of "uncertain value." The original proposed guaranty in lieu of cash was in the form of notes of the subscribers (R. 50). Payment of these notes, as subsequent history shows, would have been made pro rata in 1920. The substitution of a guaranty fund in cash in lieu of the notes was made necessary so that the Trust Company when re-opened in 1906 should have a more liquid position than such notes of the guarantors would have afforded.

The relationship, however, of the subscribers to the Trust Company in the transaction was still that of guarantors with the expectation that the guaranty fund, plus a profit, would be returned to them. This relationship seems to the respondent essentially different from that of the taxpayers in the cases relied upon by the petitioner, and it is asserted for the respondent that Section 202 (a) (1) of the Revenue Act of 1918, and the regulations promulgated thereunder, by language and intent, have no application to the transaction out of which arose the loss claimed by the respondent under Section 214 (a) (5) of that Statute.

The argument for the petitioner, if applied to the actual facts of the transaction under consideration and not to the relationship as inaccurately described in the petitioner's brief, would require that in every contract of suretyship or guaranty entered into prior to March 1, 1913, and resulting

in a loss thereafter, the position of the surety or guarantor must be valued as of March 1, 1913, in determining the amount of the deductible loss allowable in the year when the transaction involving the suretyship or guaranty is closed. The language of Section 202 (a) (1) of the Act of 1918 certainly does not *expressly* justify such a contention, and there is no *reasonable implication* from that language of the statute that to determine the loss allowable under Section 214 (a) (5) such a valuation of the guarantor's position is required.

Evidence which is reasonably conclusive that the administrative department of the Government placed no such construction upon Section 202 (a) (1) is found in the reason of the Commissioner of Internal Revenue for disallowing the loss claimed by the respondent. This reason includes no suggestion that the respondent failed to establish his loss upon the basis of the provisions of Section 202 (a) (1), nor was the claim of loss disallowed by the Commissioner by reason of a finding by him that the respondent's position had no value on March 1, 1913, but was for the reason that (Record, p. 45) :—

> "In regard to the disallowance of $271,700.00, you are advised that under the provisions of revenue act of 1918 no loss can be determined with respect to the transaction in question until the stock which you received as reimbursement is disposed of, and the evidence is to the effect that the stock was still in your possession at the close of the year 1920."

The petitioner in the brief below, and in the brief filed on this hearing, does not refer to any provision of the revenue acts, the regulations promulgated thereunder, nor to any reported case, embodying the requirement imposed by the argument for the petitioner here that a loss arising out of a transaction in the nature of a guaranty requires a valuation of the guarantor's position as of March 1, 1913, before the

loss actually sustained and deductible under Section 214 (a) (5) may be allowed.

An analagous situation would be an agreement of guaranty entered into in 1906 by A as guarantor of the indebtedness incurred by partnership B and partnership C in neither of which was A a member, with a manufacturer from whom they purchased goods; the consideration to A being that each of the dealers would pay to A a percentage of the profits realized on the sale of the goods purchased from the manufacturer holding the agreement of indemnity at the expiration of the time when each partnership ceased selling these goods. The relationship between the selling partnerships and the manufacturer continued until 1920. In that year partnership B ceased to purchase from the manufacturer, dissolved and having paid in full all of its indebtedness to the manufacturer, showed a substantial profit on the goods which it had sold, from which A was paid the agreed percentage. Partnership C showed a substantial loss when liquidated, resulting in the payment by A on his agreement of indemnity of a substantial sum to the manufacturer from whom C had purchased the goods which it had sold.

Is it conceivable that, in determining the income tax liability of taxpayer A for the year 1920, the income in the form of the profits received from partnership B and the loss sustained by the payment under his contract of guaranty of the indebtedness due by partnership C to the manufacturer are not determinable without a valuation of A's position under his two contracts of guaranty as of March 1, 1913? It would seem that an attempt by A so to do would be met by serious opposition on the part of the Commissioner of Internal Revenue.

Another example would be afforded by the situation where A in 1912 agrees to sell merchandise to B with deliveries running into 1914 and guarantees B against any fall in the 1914 market price as compared to the contract price. Even though the market had fallen in 1913, *non constat* but that it would rise in 1914 and hence A's possible loss in 1913

theoretically based on a 1913 market, would appear to be irrelevant. See in this connection:

Highland Milk Condensing Co. *v.* Phillips, 34 Fed. (2d) 777, certiorari denied 280 U. S. 608;
Ewing Thomas Converting Co. *v.* McCaughn, 43 Fed. (2d) 503.

A further analagous situation, because it involves similiar contingencies, may be found in the reported cases passing upon the tax liability of an insurance agent as to renewal premiums paid under contracts of agency entered into prior to March 1, 1913.

Workman *v.* Commissioner of Internal Revenue, 41 Fed. (2d) 139 (C. C. A. 7th Circuit). In this case, the taxpayer received in the years 1920 to 1924 various amounts on renewal premiums of policies, which as agent for an insurance company, he had written prior to March 1, 1913. His contract with the insurance company entered into in 1908 entitled him to receive commissions on renewal premiums, regardless of the termination of his agency. In making his returns of income for 1922, 1923 and 1924, he excluded the amount of the commissions received in those years on the renewal premiums, presumably on the theory that the March 1, 1913, value of the anticipated payments to him under his contract exceeded the amounts actually received by him in said years. The Commissioner determined that the taxpayer's income should be increased by the amounts actually received in the years in question. The Court sustained the action of the Commissioner and in considering the nature of the taxpayer's right says (p. 141) (quoting from another case):—

"* * * Although the right had value, it lacked an essential element; no renewal premium might ever be paid, and in that event he would receive nothing more; or renewals might be paid only in part, and then he would be entitled to commission on that part only. The insured might die before a given renewal fell due,

or he might allow his policy to lapse, and in either event the right of the agent to future commissions perished. The right, therefore, was contingent; his contracts so provided, for they declared that commission should accrue only as premiums should be paid in cash, and certainly until such payment should be made he had no collectible claim against the society. He had a property right that had value, but contained also an element of risk, and unless he turned it into money it remained contingent. The act taxes money, or its equivalent, or its representative, and a contingent right such as this is not 'income' in the sense used by the act. * * *

"Of course, there are instances where such contingent rights to commissions have been bartered and sold, and present values have been placed upon them by reference to mortuary tables and lapsing probabilities, with reliable accuracy; but the contingency is never eliminated so far as the agent is concerned, nor is the contingent right ever impressed with the characteristics of capital so long as the agent's right to receive it is contingent upon the nonlapsing of the policy."

The petitioner asserts that until the respondent has established the value of his position on March 1, 1913, there is no basis for determining his deductible loss, and that not only did the respondent fail to discharge this burden, but the evidence shows that "respondent's property right *had no value* on March 1, 1913." (Petitioner's Brief, p. 14.)

The basis for this assertion, as shown by the Petitioner's Brief, is that the principal unliquidated asset of the original "Segal Matters" on March 1, 1913, was 7268 shares of stock of the Pennsylvania Sugar Company, and the petitioner asserts that there was an ascertainable market value for this stock which, if ascertained, would show that the respondent's participating interest in such stock was of no value whatever.

This argument needs many assumed facts to support it

not to be found in the record and again misstates respondent's relationship to the Segal Matters in important particulars.

The respondent had no property right in the Segal Matters as such, and market values as of March 1, 1913, were of no greater use to the respondent then than they are relevant to this case now, because, regardless of market values for whatever the Segal Matters might then have been, the respondent had no power to direct the administration by the Real Estate Trust Company and no means of requiring a liquidation in 1913 of the assets which were in its hands for its sole control.

The record shows that there was no termination of the administration by the Trust Company prior to March 1, 1913, and until that event occurred the respondent was without power to require an accounting by which to ascertain the value of his position.

The Trust Company in its uncontrolled discretion continued its administration beyond March 1, 1913, and without change in the original agreement, at least until May 5, 1916. During the entire period of such administration and at the time the supplemental agreement of the later date was entered into all parties evidenced the expectation of a realization of their original subscriptions to the guaranty fund with profit or interest.

The record shows opinion evidence, competent to prove as a fact that the respondent's position as a guarantor had, on March 1, 1913, at least the value of his original contribution to the guaranty fund. This is found in the oral testimony of Samuel F. Houston (R. 49)—

> "At the time the agreement of 1916 was entered into by me I was of the opinion that if the sugar company was as successful as we anticipated and hoped the much-desired result that the Real Estate Trust Company would work out from the Segal assets a sum sufficient to return to the subscribers the amount of their contributions need not be a matter of very long time."

and in the provisions in writing of the supplemental agreement of May 5, 1916, executed by the respondent and the other parties in interest (Exhibit No. 4, R. 37-39).

Paragraph Fourth of this supplement agreement (R. 38) reads as follows:—

> "*Fourth.* That as a further consideration and adjustment that would make possible the participation of the contributors to the $2,505,000 fund so as to secure at least some return upon their equity, it is hereby provided and agreed that should the Real Estate Trust Company of Philadelphia, in its discretion, dispose of any or all of the stock of the Pennsylvania Sugar Company, owned by the trust company as part of the 'Segal Matters' twenty-five per cent. of the proceeds of such sale or sales, or so much thereof as may be required to return the contributions without interest, shall thereupon be distributed pro rata among the contributors to the said $2,505,000 fund on account of their contributions up to the amount of the same which at that time shall remain unreturned. The remainder of the proceeds of any such sale or sales shall be and remain the absolute property of the Real Estate Trust Company of Philadelphia."

The language of this agreement, involving matters so important to all concerned, cannot be lightly brushed aside, but must be given proper weight as a clear indication that even as late as 1916, the respondent and other subscribers to the guaranty fund had a reasonable expectation of a return of their subscriptions made in 1906.

On the other hand, the Trust Company, administrator, and the members of its board, in conceding by this agreement an opportunity to the subscribers to the guaranty fund to realize from sales from time to time, if and when made, of the share of stock of the Pennsylvania Sugar Company, a participation, to the extent of twenty-five per cent. of the

proceeds of such sales, instead of requiring them to await the final recoupment to its full extent of the original position of the Trust Company, obtained, as a consideration for this earlier payment, a waiver by the subscribers of the excess profits then anticipated from the sale of *all* of such stock and the acceptance of the original contribution only and no additional profit.

The "Segal Matters" had in 1906 an *uncertain value*. This fact is stipulated in the record (p. 21). As of March 1, 1913, they had an equally *uncertain value*. In either case all parties familiar with the possibilities of the administration by the Trust Company confidently anticipated an ultimate realization to the subscribers to the guaranty fund of their original subscriptions with interest or profit. The most that could be required of this respondent was that, in the language of Relnecke *v.* Spalding, 280 U. S. 227, he should prove that the value of his position on March 1, 1913, was at least not below what it was as a member of the Guarantors' group in 1906. This he has done.

The action of this respondent throughout was based, as Mr. Justice Stone said in Llewellyn *v.* Electric Reduction Co., 275 U. S. 243, "on faith in a prophecy," and at no time while his faith continued was he in a position "to claim to have sustained a loss, before the future" failed "to justify his hopes."

CONCLUSION.

The decision of the Circuit Court of Appeals for the Third Circuit should be affirmed.

Respectfully submitted,

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